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In the Supreme Court of the United States

OCTOBER TERM, 1966.

THE CREDITORS' COMMITTEE OF DRIVE-IN DEVELOPMENT CORP.; CITY NATIONAL BANK OF CLEARWATER; SARASOTA BANK AND TRUST COMPANY; ERVITE CORPORATION,

Petitioners,

vs.

NATIONAL BOULEVARD BANK OF CHICAGO,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petition for Writ of Certiorari in Drive-In

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered December 19, 1966 insofar as it reversed in part an order of the District Court confirming on a petition for review an order of a Referee in bankruptcy disallowing in its entirety respondents' claim against Drive-In Development Corp., debtor, in proceedings under Chapter XI of the Bankruptcy Act.

Citations to Opinion Below.

The opinion of the court below is reported in 371 F.2d 215, and is printed in Appendix A hereto, *infra* p. 1a.

Jurisdiction.

The judgment of the Court of Appeals was entered on December 19, 1966. A timely petition for rehearing by petitioners herein was denied on January 18, 1967. The jurisdiction of this Court is invoked under 28 U.S.C., § 1254 (1).

QUESTIONS PRESENTED

1. Does a corporate secretary's certificate misrepresenting the adoption of a resolution purporting to authorize a guaranty of a sister subsidiary corporation's obligation operate as an estoppel against creditors of a debtor in proceedings under Chapter XI of the Bankruptcy Act when the creditors object to a claim founded on an unauthorized guaranty broader in scope than the guaranty purportedly authorized in the false certificate when there was neither proof of reliance in good faith upon the secretary's certificate nor proof of direct and material benefit to the corporation?

2. Can an estoppel to deny the authority of an officer to execute an unauthorized guaranty arise because it was within the authority of the corporate secretary to certify the adoption of resolutions generally in the absence of proof of reliance in good faith and in the exercise of reasonable prudence upon the certificate?

3. Did the Court of Appeals err when it failed to follow Illinois law that one dealing with an agent of a corporation has the burden of proving the agent's authority to bind the principal to the particular contract on which

he rests his claim and that one asserting an estoppel has the burden of proving the elements necessary to establish an estoppel?

Statement of the Case

On November 19, 1963, respondent, National Boulevard Bank of Chicago, a national banking corporation, filed a claim of $1,839,942.32 against Drive-In Development Corp., an Illinois corporation, debtor in arrangement proceedings under Chapter XI of the Bankruptcy Act in the United States District Court for the Northern District of Illinois (App. 3-9, 172-177).

Respondent's claim was based upon an instrument in writing, dated April 11, 1962, never authorized by the debtor and reading in part as follows:

> "For value received and to induce National Boulevard Bank of Chicago (Bank) to purchase with recourse, certain chattel paper from Allied Business Credit Corporation, an Illinois corporation (A.B.C.), we jointly and severally guarantee full and prompt payment by A.B.C. of its obligation to repurchase any of such chattel paper which becomes and remains in default for ninety (90) days, to the extent of Five Million Five Hundred Thousand Dollars ($5,500,000); and we jointly and severally agree to pay, in addition thereto, all costs, expenses and reasonable attorneys' fees paid or incurred in endeavoring to collect such obligation or any part thereof and in enforcing this instrument." (App. 173-174)

In addition to waiving customary defenses, the instrument provided as follows:

> "In order to hold the undersigned liable hereunder, there shall be no necessity or duty on the part of the bank to resort at any time to A.B.C. or to any other person or corporation or to any collateral or security or property whatsoever." (App. 174-176)

The instrument was executed by Leo S. Maranz and G. M. Dick on behalf of Freez-King Corp., Harlee Mfg. Co., Tastee-Freez Industries, Inc., Carrol's Drive-In System, and purportedly on behalf of the debtor, Drive-In Development Corp. (App. 6-9, 173-177) Freez-King Corp., Harlee Mfg. Co., Carrol's Drive-In System, and Drive-In Development Corp., as well as Allied Business Credit Corporation, were the wholly-owned subsidiaries of Tastee-Freez Industries, Inc. (App. 182) (Subsequent to the time in question, Freez-King Corporation and Carrol's Drive-In System, Inc. were merged into the parent company, Tastee-Freez Industries, Inc.)

Leo Maranz was the chairman of the board and president of Tastee-Freez Industries, Inc., a director and president of Allied Business Credit Corporation, chairman of the board of Freez-King Corporation, and chairman of the board of Harlee Mfg. Co. Leo Maranz was also one of three directors and vice president of Drive-In Development Corp.

G. M. Dick was a director of each of the above named corporations, treasurer of Tastee-Freez Industries, Inc., vice president of Allied Business Credit Corporation, and secretary of Drive-In Development Corp. (App. 79-81)

Hugh Driscoll was a director of Tastee-Freez Industries, Inc., the parent corporation, and was at all times familiar with the Tastee-Freez complex of corporations. At the same time he was a director, executive vice president and chairman of the loan committee of respondent, National Boulevard Bank of Chicago. (App. 183-187)

Freez-King Corporation manufactured and sold equipment including freezers useful in the soft ice cream dispensing business. It assembled and sold mobile soft ice cream dispensing units or "mobile units." (App. 181) All

of the conditional sales contracts included in respondent's claim which were in default are contracts covering mobile units. (App. 182)

Allied Business Credit Corporation financed sales of equipment and mobile units by Freez-King Corporation. It purchased conditional sales contracts which Freez-King Corporation had received upon the sale of equipment to third persons. It then discounted such contracts to financial institutions including respondent. (App. 181-182)

Drive In Development Corp. leased or purchased sites for Tastee Freez and Carrol's Drive In Systems, Inc., fixed location stores. (App. 182) Its president operated in the field obtaining financing for Drive In's purposes. (Appellee's Appendix, p. 5)

On April 9, 1962 Allied Business Credit Corporation (A.B.C.) by G. M. Dick, entered into a contract with respondent bank that set forth the terms by which the conditional sales contracts would be assigned by A.B.C. to respondent bank. One of the terms of the contract provided as follows:

> "In the event the whole or any part of any installment payment due under the terms of chattel paper assigned to the Bank becomes and remains in default for a period of ninety (90) days, then and in that event A.B.C. agrees, upon demand of the Bank, to repurchase such chattel paper for a price equal to the unpaid balance due under the terms of such chattel paper in default." (Appendix 182-183)

On April 10, 1962 the Loan Committee of respondent, which included Hugh Driscoll, a director of Tastee Freez Industries, Inc., approved the purchase from Allied Business Credit Corporation of up to $2,000,000 (net) in paper without the full guaranty of Leo and Esther Maranz

"which is now in process of preparation, present guaranty $1,100,000."

Thereafter, Leo Maranz and his wife, Esther Maranz, executed and delivered to respondent a document "to induce National Boulevard Bank of Chicago (the Bank) to purchase from Allied Business Credit Corporation, an Illinois corporation, (A.B.C.), in which we have a substantial financial interest, all of its right, title and interest in to and under certain chattel paper, agreeing in the event the whole or any part of any installment paper provided for under the terms of an item of chattel paper assigned to the Bank by A.B.C. bcomes due and remains in default for a period of ninety (90) days or more to pay to the Bank upon its demand an amount equal to the unpaid balance due under the terms of such items of chattel paper." (App. 136-137, 138)

Leo Maranz had on deposit with respondent municipal bonds in an amount of approximately $2,000,000 and shares of Tastee Freez stock and other stock which secured this undertaking as well as direct personal obligation. (App. 43-44, 137, 183)

Thereafter, William Schneider, a vice president of respondent, telephoned G. M. Dick and asked him to prepare certain instruments purporting to be copies of corporate resolutions relating to the assignment of Freez King conditional sales contracts by A.B.C. to respondent. Dick was unable to recall whether respondent gave him the language of the certificates or whether he copied it from something else.

Neither on April 11, 1962 nor any other time did Drive In's directors adopt the resolution referred to in the certificate, nor did they ever adopt any other resolution authorizing the guaranty executed by Maranz. (App. 184-185)

Dick's certificate recited that on April 11, 1962 the following resolution was adopted by Drive In's board of directors:

> "Be It Resolved:
>
> "That the officers of this corporation are authorized to execute on behalf of the corporation, a guaranty to the National Boulevard Bank of Chicago under which this corporation agrees to guarantee full and prompt payment of the obligation of Allied Business Credit Corporation to National Boulevard Bank of Chicago to repurchase chattel paper which remains in default for ninety (90) days, to the extent of Five Million Five Hundred Thousand Dollars $5,500,000)." (App. 184)

Dick prepared similar certificates with identical resolutions for Freez King, Harlee Mfg. Co. and Carrol's Drive In Systems, Inc. (App. 184-185)

There was no evidence that Drive In's president, Sylvan Spira, who was the third member of Drive In's board of directors, knew about the purported guaranty or knew about Maranz' agreement with respondent or the collateral which Maranz had on deposit with respondent which the purported guaranty permitted to be released. (App. 185) There was no evidence of any direct and material benefit to Drive In Development Corp. from respondent by reason of the guaranty. (App. 186)

An indirect benefit was urged from the fact that Drive In was lent money by Freez King, which received money from A.B.C., which received money from respondent bank.

The Referee and the District Judge determined that the purported guaranty was an extraordinary and unusual contract; that Leo Maranz had no authority either actual or implied or apparent to bind Drive In Development Corp.; that the purported guaranty executed by Maranz

was broader than the purported resolution contained in Dick's certificate; that respondent knew or should have known that Maranz had no authority; that respondent failed to prove any reliance on any apparent authority on the part of Maranz; that Drive In did not at any time authorize the execution of the guaranty by Maranz, nor did Drive In adopt or ratify Maranz' action in executing the guaranty either actually or constructively; that the Creditors' Committee of Drive In and certain individual creditors which objected to respondent's claim were not estopped to assert that Drive In did not authorize the guaranty and that even had the purported guaranty actually been authorized by Drive In Development Corp., that only $436,965.03 of respondent's claim would be allowable. (App. 185-190, 195; Appellee's App. 24-32)

On petition for review to the district judge, respondent urged that Dick's certificate was *prima facie* evidence of Maranz' authority. (App. 192)

On appeal, respondent raised no factual questions. It conceded that the clear error rule precluded any attack upon the findings of fact.

The court below held:

> "Drive In was estopped to deny Maranz' express authority to sign the guaranty because of the certified copy of a resolution of Drive In's board of directors purporting to grant such authority furnished to the bank by Dick, whether or not such a resolution was in fact formally adopted."

The court below noted that Dick was secretary of the corporation, that generally it is the duty of the secretary to keep the corporate records and to make proper entries of the actions and resolutions of the directors.

The court below reasoned:

> "Therefore it was within the authority of Dick to certify that a resolution such as challenged here was adopted. Statements made by an officer or agent in the course of a transaction in which the corporation is engaged and which are within the scope of his authority are binding upon the corporation. Consequently Drive In was estopped to deny the representation made by Dick in the certificate forwarded to National Boulevard, in the absence of actual or constructive knowledge on the part of the Bank that the representation was untrue."

The court below held that petitioners here failed to prove knowledge on the part of respondent that the certificate of resolution furnished by Dick was false.

The court below also reasoned:

> "Drive In was part of an integrated business enterprise and whatever benefited one part of the enterprise benefited all, * * * Although intercorporate contracts of guaranty do not usually occur in the regular course of commercial business, here the inter-relationship of Tastee Freez and its subsidiaries presented a situation in which the guaranty was not so unusual as would ordinarily obtain. Furthermore, the realities of modern corporate business practices do not contemplate that those who deal with officers or agents acting for a corporation should be required to go behind the representations of those who have authority to speak for the corporation and who verify the authority of those who presume to act for the corporation."

For these reasons the court below reversed in part and ordered the allowance of the claim to the extent of $436,965.03.

REASONS FOR GRANTING THE WRIT

In Illinois, as elsewhere, it is elementary that in addition to representation, estoppel to deny authority requires reliance in good faith and in the exercise of reasonable prudence. *State of Oklahoma* v. *State of Texas,* 268 U.S. 252, 257-258; *Alterman* v. *Lydick,* 241 F. 2d 50, 52 (C.A. 7th Cir. 1957); *Crittendon* v. *State Oil Co.,* 78 Ill. App. 2d 112, 116 (1966); 31 C.J.S. "Estoppel," § 71, pp. 428-438.

In the District Court respondent had argued that the certificate was *prima facie* evidence of authority. (Petition for Review, paragraph 3, Appendix 192-193). But in the court below the respondent was permitted to argue successfully that the certificate was conclusive and without proof of either reliance or direct and material benefit. (App. 186-189) (Appellees' App. 14) Dick's misrepresentation was not made in a transaction in which *Drive In Development* was engaged.

The court below, in sustaining the bank's argument, overlooked entirely the fact that the guaranty which Maranz executed on behalf of Drive In without authority was far greater in scope than contained in the purported resolution recited in Dick's certificate. Thus, the guaranty executed by Maranz waived usual defenses available to an accommodation guarantor and permitted Maranz' collateral to be released to him, whereas the resolution in Dick's certificate merely authorized "a guaranty." (App. 173-176, 178-179)

The court below overlooked evidence that respondent contemplated using Dick's certificate to document an entirely different guaranty (Appellees' Appendix 19-20) and that respondent knew that it should have opinion of counsel in a similar and related transaction. (Appellees' Appendix 18-20) Respondent charged with knowledge of Illinois law knew or should have known the *ultra vires*

character of the resolution recited in Dick's certificate. *Culhane* v. *Swords Company*, 281 Ill. App. 185, 200-201; *Rogers* v. *Jewell Belting Company*, 184 Ill. 574. (App. 189, Appellees' App. 29) No estoppel could arise in the circumstances for respondent could not be misled. See, *Franklin National Bank* v. *Whitehead*, 149 Ind. 560, 577-578, 49 N.E. 592.

The practical, commercial effect of the holding of the court below will be that corporate subsidiaries will find it more difficult to obtain credit. Reasonably prudent creditors will be required to inquire into the financial situation of each of a subsidiary's sister corporations in order to ascertain whether the financial standing and potential liabilities of the borrowing subsidiary is as represented in its books and records. The Referee perceived the situation, saying:

> "All you have to do is shuffle these corporations around to the detriment of creditors everywhere." (Appellees' App. 15)

Dick, who testified for respondent, admitted under cross examination that he could not recall that he had ever seen a financial statement of Drive In Development which showed in any way a potential liability on the National Boulevard guaranty by footnote or otherwise. (Appellees' App. 6)

We fear that the Seventh Circuit Court of Appeals condones pragmatically vague banking practices for a national bank. The "realities" of the situation were clearly perceived by the Referee and the District Judge. Respondent looked to Leo Maranz and his collateral. The purported guaranty was paper taken for whatever it was worth but it was not relied upon in extending credit to A.B.C. The unauthorized attempt by Maranz to

bind Drive In Development Corp. was not a condition of the extension of credit to Allied Business Credit Corporation but was an attempt by Maranz to substitute the assets of Drive In Development Corp., which should have been available primarily for the protection of Drive In's creditors who are numerous and are located throughout the United States.

We submit that the court below has announced a new and improvident principle that is contrary to established commercial and equitable principles and which is destructive of the rights of creditors in bankruptcy proceedings.

The court below erroneously placed the burden upon the objecting creditors to prove knowledge on the part of respondent of the falsity of Dick's certificate when the burden was upon respondents in asserting an estoppel to prove reliance in good faith and in the exercise of reasonable prudence.

Estoppel is a doctrine of equity and bankruptcy courts in passing on claims are courts of equity. *Pepper* v. *Litton,* 308 U.S. 295, 304-306. The application of an estoppel by the court below against *bona fide* creditors of Drive In Development Corp. that actually furnished the debtor corporation with good services and money so that respondent may receive a distribution of Drive In's assets on a parity with Drive In's *bona fide* creditors is, we respectfully urge, erroneous. For these reasons the matter is an appropriate one for the consideration of this court in connection with the proper administration of the Bankruptcy Act. Congress intended that Act to afford reasonable relief to debtors but it also intended that *bona fide* creditors be protected from raids by insider creditors on purported guaranties.

CONCLUSION

For the foregoing reasons, it is urged that this Court grant this petition.

Respectfully submitted,

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